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Nos. 89-1988, 89-1989, 89-1990, 89-2000, 89-2016

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

THE BERKSHIRE GAS CO., *et al.*, *Petitioners*,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*

TENNESSEE SMALL GENERAL SERVICE CUSTOMER GROUP, *et al.*, *Petitioners*,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*

TENNESSEE GAS PIPELINE COMPANY, *Petitioner*,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*

NATIONAL FUEL GAS SUPPLY CORPORATION, *Petitioner*,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*

FEDERAL ENERGY REGULATORY COMMISSION, *Petitioner*,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission has the power, under the Natural Gas Act, 15 U.S.C. § 717 *et seq.*, to impose on the customers of a natural gas pipeline a surcharge, based on each customer's gas purchases in earlier years, in addition to the rates and charges that were on file with the Commission when the purchases were made.

RULE 29.1 STATEMENT

Respondents Columbia Gas Transmission Corporation, Columbia Gas Distribution Companies, Inc., and The Inland Gas Company, Inc. are wholly-owned subsidiaries of The Columbia Gas System, Inc.

Respondents CNG Transmission Corporation and The Peoples Natural Gas Company are wholly-owned subsidiaries of The Consolidated Natural Gas Company.

Respondent Baltimore Gas and Electric Company has an affiliate: Safe Harbor Water Power Corporation.

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BRIEF FOR RESPONDENTS IN OPPOSITION

STATEMENT

In 1988, the Federal Energy Regulatory Commission authorized Tennessee Gas Pipeline Company (Tennessee) to charge its customers up to an additional $650 million,

on the basis of the extent to which each customer's average annual purchases in 1983-86 declined from its average annual purchases in 1981-82. The charge to each customer was to be in addition to the rates and charges Tennessee had on file (and which were approved by the Commission) in 1981-86, and was computed without regard to the customer's current gas entitlement or gas purchases. The court of appeals invalidated this retroactive additional charge on the ground that it "violate[s] the filed rate doctrine as expressed in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981)." Pet. App. 11a.[1]

1. In the late 1970s and early 1980s, after several years of gas shortages and the deregulation of certain gas supplies by the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.*, many pipelines, including Tennessee, "enter[ed] into long-term contracts to purchase additional gas supplies at high prices and subject to high take-or-pay requirements."[2] Beginning about 1982, however, demand for gas fell as a result of rapidly increasing gas prices, declining oil prices, recession, warm weather, and other factors.[3] As a result, by late 1982, Tennessee's customers were purchasing less gas and Tennessee, like other major pipelines, was "confronted with an increasingly severe imbalance between the gas supplies deliverable to it under gas contracts . . . and the ability of its

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[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari in *Tennessee Gas Pipeline Co. v. Associated Gas Distributors*, No. 89-1990 (filed June 21, 1990).

[2] Order No. 500-H, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regs. Preambles ¶ 30,867 at 31,509 (Dec. 13, 1989) (final rule). A "take-or-pay" contract provision requires a buyer of gas to pay for a specified minimum volume each year (generally 75-90% of the amount deliverable under the contract) whether or not it takes that much gas. If the buyer does not take the minimum volume, it must "prepay" for the remaining gas and may then "recoup" that gas over a specified future period after which recoupment rights may be forfeited.

[3] *See id.* at 31,510.

markets to absorb natural gas at Tennessee's current price levels." Tennessee April 29, 1983, letter to producers, Exhibit No. TMM-10 at 1, R. 4117 (*see* Appendix, *infra,* 1a).

By 1986, this imbalance forced Tennessee to initiate two kinds of strategies to extricate itself from its contracts. Tennessee sought to "buy out" its accumulated take-or-pay liabilities for gas not taken in past periods and to "reform" its purchase contracts to reduce or eliminate the continuing gap between its high contract prices and the lower current market prices of gas. *See Tennessee Gas Pipeline Co.*, 36 FERC ¶ 61,032 (1986).

According to Tennessee estimates later accepted by FERC, these costs were about one-third "buyout" costs and two-thirds "contract reformation" costs. It was estimated that by the end of 1985, Tennessee's accumulated take-or-pay liabilities were $1.75 billion and that these liabilities could be bought out at 20 cents on the dollar, or $350 million. *See* Pet. App. 115a-116a. It was estimated that at the end of 1985 the "present value of differences between contract prices and spot market prices under Tennessee's contracts totalled $1.5 billion" and that it would cost Tennessee 50 cents on the dollar, or an additional $750 million, to reform these contracts. *Id.* at 115a.

2. Respondents were direct and indirect customers of Tennessee in 1981-86.[4] FERC's orders in this case authorized Tennessee to collect a surcharge from its cus-

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[4] Respondents include interstate pipelines, other regulated sellers of natural gas, industrial and other gas end users, and state regulators and consumer advocates. Those respondents that are regulated entities have their own obligations, under federal and/or state law, to file rate schedules and to abide thereafter by their filed rates. All of the respondents make decisions concerning gas purchases, including choices between alternative suppliers or between natural gas and alternative fuels, based on the information contained in their vendors' filed rate schedules.

tomers for up to $650 million of the cost of extricating itself from its gas supply purchase contracts. But FERC's orders are not based on any factual finding that particular respondents either were responsible for or benefited from Tennessee's oversupply. To the contrary:

First, there has been no Commission determination of the extent to which Tennessee's own actions in entering into high-price take-or-pay contracts were "prudent." [5] And the Commission has never suggested that any customer induced Tennessee to enter into what later proved to be disastrous contracts.

Second, this case does not involve any breach of contract or violation of tariff by Tennessee's customers. The shorthand terms "deficiency period" (to refer to the years 1983-1986) and "deficiency" (to refer to a decline in a Tennessee customer's purchases between 1981-82 and 1983-86) refer simply to the decline in purchases by customers between the two past periods and should not be taken to imply that any customer that bought less gas in the 1983-86 period failed to comply with any of its obligations.

Tennessee's customers in 1981-86 were not obligated to purchase any specific amount of gas. They paid (i) a fixed "demand charge" based on their gas purchase entitlements (essentially a capacity reservation charge) and (ii) a "commodity charge" for the volumes of gas actually purchased. *See Tennessee Gas Pipeline Co. v. FERC*, 871 F.2d 1099, 1103 n.5 (D.C. Cir. 1989). They were also subject to a "minimum bill" tariff provision under which each Tennessee customer was required to pay Tennessee as if it had taken 66⅔ percent of its con-

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[5] The Commission's administrative law judge found that Tennessee was prudent in incurring its take-or-pay obligations. *See* Pet. App. 70a. This finding was extensively challenged before the Commission, which has ruled that any Tennessee customer may pursue a challenge to Tennessee's prudence, but only at the risk of a higher eventual surcharge based on past purchases. *Id.* at 105a.

tract entitlement, even if it did not take that much gas. Insofar as is relevant here, the customers met all of their contract and minimum bill obligations.[6]

On June 1, 1984, nearly a year and a half into the later-defined "deficiency period," the Commission barred the inclusion of variable costs (primarily the cost of the gas itself) in pipeline minimum bills. Order No. 380, *Elimination of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions*, FERC Stats. & Regs., Regs. Preambles ¶ 30,571 (June 1, 1984). On a case-by-case basis, the Commission later barred pipeline minimum bills altogether, *see* Order No. 500-H, FERC Stats. & Regs. at 31,511, eliminating Tennessee's minimum bill effective August 1, 1987—well after the deficiency period was over. *Tennessee Gas Pipeline Co.*, 36 FERC ¶ 61,071, *reh'g*, 40 FERC ¶ 61,140 (1987).[7]

[6] Petitioner Berkshire Gas Company's assertion (Pet. 8) that respondent Columbia Gas Transmission Corporation violated Tennessee's minimum bill is flatly wrong. Although Columbia did not take as much gas in 1983 as the minimum bill purportedly obligated it to pay for, Columbia had no obligation to take any quantity of gas. Columbia sought a waiver from the Commission of any minimum bill payments to Tennessee. That matter was resolved by a settlement under which Columbia and certain other customers, in lieu of the minimum bill, paid the fixed cost portion of the minimum bill and their proportionate share of Tennessee's take-or-pay liabilities to gas producers. *Columbia Gas Transmission Corp. v. Tennessee Gas Pipeline Co.*, 29 FERC ¶ 61,208 (1984), *reh'g*, 31 FERC ¶ 61,053 (1985). The terms of this settlement were extended, with modifications, through July 1984. *Columbia Gas Transmission Corp.*, 31 FERC ¶ 61,307 (1985), *reh'g*, 34 FERC ¶ 61,219 (1986). There is no basis whatever for Berkshire's implication that noncompliance by any customer with any contract provision was the cause of Tennessee's take-or-pay problem.

[7] On review of FERC's determination to eliminate its minimum bill as anticompetitive, Tennessee argued that the minimum bill was needed to reduce Tennessee's exposure on account of its take-or-pay liabilities to producers. This claim was rejected by the court of appeals. *Tennessee Gas Pipeline Co. v. FERC*, 871 F.2d 1099, 1106 (D.C. Cir. 1989).

FERC abolished minimum bills because it found they were "fundamentally inconsistent with the increasingly competitive wellhead market mandated by the Congress in 1978." Order No. 380, FERC Stats. & Regs. at 30,964. FERC noted that it "ha[d] encouraged regulated utilities to pursue least-cost [gas purchasing] strategies" and found that "the presence of variable costs in minimum commodity bills thwarts this policy." *Id.*

The record does not establish the extent to which those Tennessee customers that reduced their purchases in the 1983-1986 deficiency period did so because of (i) lower overall gas demand (due to factors such as reduced economic activity, higher energy prices, and conservation measures by residential and other users), (ii) switches by *their* customers to less expensive alternative fuels or alternative gas supplies, or (iii) the partial elimination of minimum bills in 1984. But three things are clear: First, even a customer that purchased its 66⅔ percent minimum bill quantities in 1983-86 could have a large "deficiency" compared to the 1981-82 period, when many of Tennessee's major customers were purchasing 100 percent of their contract entitlements. Second, to the extent that any Tennessee customer, partially freed from the minimum bill, bought lower cost gas elsewhere, it was doing exactly what the Commission had intended it to do.[8] Third, any reduction in purchases to (or below) minimum bill levels pursuant to the Commission's stated policies would be overwhelmingly punished by the surcharge the Commission would impose on purchase reductions during the 1983-1986 period.[9]

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[8] During this same time, state regulators were also enforcing least-cost purchasing policies in approving retail rates for gas service. *See, e.g., Kentucky West Virginia Gas Co. v. Pennsylvania Pub. Utils. Comm'n*, 837 F.2d 600 (3d Cir.), *cert. denied*, 488 U.S. 941 (1988).

[9] A Tennessee customer that shifted some of its 1983-86 purchases to another supplier who was offering slightly cheaper gas may well have realized a small savings. But for that effort to comply with

The Commission took a second regulatory step (which Chief Judge Wald later mistakenly claimed "let [Tennessee's customers] off the hook," Pet. App. 33a) that in fact had virtually nothing to do with declines in purchases by Tennessee's customers in 1983-86. On October 9, 1985, the Commission issued Order No. 436,[10] which created strong incentives for interstate pipelines to become "open access" transporters of gas, enabling customers connected to only one pipeline nevertheless to buy gas from suppliers other than the pipeline itself. Although revolutionary, Order No. 436 was not self-executing: Tennessee did not become an "open access" pipeline until December 1986, the last month of the "deficiency period." *See Tennessee Gas Pipeline Co.*, 38 FERC ¶ 61,004 (1987).[11]

3. On June 3, 1986, Tennessee filed a tariff change under section 4 of the Natural Gas Act (the Act), 15 U.S.C. § 717c. Anticipating that when it became an open access pipeline its gas costs under its contracts with producers would make its gas entirely uncompetitive, Tennessee announced an intention to renegotiate its producer contracts, paying producers to buy out past contract liabilities and to reform the price and other terms for the

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Commission policy and serve its own customers as cheaply as possible, the Tennessee customer has now been surprised with a surcharge equal to (i) its proportionate share of 50 percent of the *full* cost of buying out Tennessee's liability for gas not taken by Tennessee in 1983-86 and (ii) the same share of Tennessee's costs of reforming its high-price contracts so that Tennessee can *now*, and in the future, sell gas at market prices. As noted, these reformation costs, which have no relationship at all to purchase declines in 1983-86, are, according to estimates adopted by the Commission, two-thirds of Tennessee's costs involved in this case.

[10] *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regs. Preambles ¶ 30,665 (Oct. 9, 1985).

[11] In fact, under the FERC orders at issue, a Tennessee customer whose purchases began to decline only after Order No. 436 was implemented by Tennessee would bear none of the burden either of Tennessee's buyout costs or of its contract reformation costs.

future. To fund its renegotiation program, Tennessee sought Commission authority to bill directly to its customers (outside of normal demand charges and commodity sales rates) 80 percent of its buyout and reformation costs and proposed to absorb the remaining 20 percent.[12] On July 2, 1986, the Commission issued an order rejecting the tariff filing but setting the matter for hearing to enable Tennessee to make a factual record in support of the proposal.[13] *See* Pet. App. 95a-96a.

Meanwhile, in a 1985 policy statement, the Commission had reaffirmed its traditional policy that prudent buyout and reformation costs, associated with take-or-pay contracts prudently entered into, could be treated as gas supply costs and reflected in a pipeline's *current* sales commodity rates.[14] However, following a March 5, 1987, Proposed Policy Statement,[15] the Commission on August 7, 1987, issued Order No. 500 [16] adopting a new policy, 18 C.F.R. § 2.104, that offered pipelines the opportunity

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[12] Tennessee also proposed to absorb all such costs paid to affiliated gas producers.

[13] *Tennessee Gas Pipeline Co.*, 36 FERC ¶ 61,032 (1986).

[14] *Regulatory Treatment of Payments Made in Lieu of Take-or-Pay Obligations*, FERC Stats. & Regs., Regs. Preambles ¶ 30,637 at 31,300 (Apr. 10, 1985) ("1985 Policy Statement"). The traditional policy is reflected in 18 C.F.R. § 2.104(a), which provides that "pursuant to existing Commission policy and practice . . . pipelines may pass through prudently incurred take-or-pay buyout and buydown [reformation] costs in their sales commodity rates." *See also*, Pet. App. 71a-72a; *Take-or-Pay Provisions in Gas Purchase Contracts: Statement of Policy*, FERC Stats. & Regs., Regs. Preambles ¶ 30,410 (Dec. 16, 1982).

[15] *Recovery of Take-or-Pay Buy-out and Buy-down Costs by Interstate Natural Gas Pipelines*, 38 FERC ¶ 61,230 (1987).

[16] *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regs. Preambles ¶ 30,761 (Aug. 7, 1987) (interim rule). Order No. 500 was remanded to the Commission in *American Gas Ass'n v. FERC*, 888 F.2d 136 (D.C. Cir. 1989) (*AGA*). In response to *AGA*, the Commission issued Order No. 500-H on December 13, 1989, and Order No. 500-I on February 12, 1990 (FERC Stats. & Regs., Regs. Preambles ¶ 30,880). Challenges

to elect an alternative recovery mechanism. A qualifying pipeline that agreed to absorb at least 25 percent of its buyout and reformation costs would be authorized to recover an equivalent amount of costs (up to 50 percent of its total) through a "fixed charge." FERC stated those fixed charges would be allocated to customers in proportion to their purchase reductions during a past deficiency period, with any remaining unabsorbed portion (up to 50 percent for a pipeline seeking fixed charge recovery of only 25 percent) recovered through a prospective "volumetric surcharge" on both gas sales and gas transportation. Order No. 500, FERC Stats. & Regs. at 30,787.

4. On July 9, 1987, a FERC administrative law judge followed FERC's March 5, 1987, Proposed Policy Statement, and ruled that Tennessee's direct-bill tariff should be allowed if it agreed to absorb 50 percent of its buyout and reformation costs. Pet. App. 80a.

On October 14, 1987, while an appeal was pending from the administrative law judge's order, Tennessee filed a proposed Stipulation and Agreement by which it proposed to recover, through fixed "demand surcharges," 50 percent of its buyout and reformation costs relating to its take-or-pay contracts, subject to an overall cap of $750 million. Consistent with its prior direct-bill proposal and the position it had taken in the administrative hearing, Tennessee proposed to allocate its take-or-pay buyout costs (which it estimated to be one-third of the total) under a complex formula that relied both on customers' respective annual entitlements under their current gas supply contracts and on three different measures

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to Order No. 500, as amended by these later orders, were heard by the D.C. Circuit on an expedited basis. On August 24, 1990, the D.C. Circuit upheld Order Nos. 500-H and 500-I, remanding two issues not relevant here. *American Gas Ass'n v. FERC*, Nos. 87-1588, slip op. at 46 (D.C. Cir., August 24, 1990). The court noted that the issues in the present case are before this Court on petitions for a writ of certiorari and did not discuss their merits. *Id.* at 44-45.

of past purchase "deficiencies." As to the costs attributed to reforming contracts for the future (estimated at two-thirds of the total), Tennessee proposed an allocation in proportion to customers' annual entitlements as of 1986 under their gas supply contracts. *See* Pet. App. 97a-98a.

On February 8, 1988, acting under section 5(a) of the Act, 15 U.S.C. § 717d(a), FERC reduced the recovery "cap" to $650 million, made other modifications, and then approved Tennessee's proposal. Pet. App. 94a-131a. FERC specifically approved Tennessee's proposed allocation of two-thirds of the costs to current customers in proportion to their contract entitlements, finding that "[t]he evidence substantiates Tennessee's expectations that ⅓ of its [subject] costs will relate to settlement of take-or-pay claims and ⅔ to contract reformation." *Id.* at 115a. The Commission expressly noted that "this allocation methodology deviates from Order No. 500, which would allocate all costs based on [past] purchase deficiencies." *Id.* at 113a.

In a May 27, 1988, order on rehearing, Pet. App. 132a-170a, the Commission, essentially without explanation and with no supporting record evidence, reversed its approval of Tennessee's cost-allocation methodology. *Id.* at 150a. FERC now required both buyout and reformation costs to be allocated solely on the basis of 1983-86 "deficiencies," declaring simply that "the allocation factors based on [contract entitlements] are unreasonable" and that "compliance with the cost incurrence principles based on past purchase deficiencies, as established in Order No. 500, is required to ensure the reasonable allocation of costs on Tennessee's system." [17] *Id.*

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[17] This February to May flip-flop by the Commission undercuts petitioners' repeated assertions that deficiency-based allocation of direct billing costs is the only "just and reasonable" recovery mechanism. Berkshire Pet. 4; Tenn. Small Cust. Group Pet. 7, 19-20. Contrary to Tennessee's assertion, Pet. 11, the court of appeals did not reach the issue of whether deficiency-based recovery is just and reasonable.

In its order on rehearing, FERC rejected the contention that "allocation of take-or-pay [buyout and contract reformation] costs cannot be based on customers' past purchase decisions and that to do so constitutes retroactive ratemaking." *Id.* at 157a. FERC said (*id.* at 158a):

> Costs that a pipeline will pay to buy out take-or-pay exposure, reform contracts, or reserve future deliveries are a current expense. These costs are merely being allocated on the basis of past purchase deficiencies, a methodology that links more closely current cost incurrence with cost causation. That this methodology relies on historical purchase data does not turn it into retroactive ratemaking.

5. On petitions for review, the court of appeals rejected this reasoning and vacated the Commission's orders. Pet. App. 1a-28a. The court agreed with challengers that the charges authorized by the Commission constituted a "retroactive change in rates without advance notice and therefore violate[d] the filed rate doctrine as expressed in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981)." *Id.* at 11a. The court noted that the effect of the Commission's orders was that Tennessee's customers "are expected to pay a surcharge, over and above the rates on file at the time of sale, for gas they had already purchased." *Id.* at 14a. The court added, "Indeed, the Commission now even forces past customers who no longer purchase *any* gas from Tennessee to pay their share of the take or pay liability." *Id.* at 13a (emphasis by the court).

The court of appeals rejected FERC's argument that because Tennessee was *currently* incurring the buyout and reformation charges, the Commission was not engaging in impermissible retroactive ratemaking when it authorized Tennessee to bill these charges to customers on the basis of past gas sales. Noting the importance of advance notice to customers of the costs of gas service, the court said, "the relevant question is not which costs

are 'current' and which are 'past.' Rather, the appropriate inquiry seeks to identify the purchase decisions to which the costs are attached." *Id.* The court agreed with challengers that, while the Commission may certainly use "historical data" in its ratemaking determinations, "the Commission may not impose a direct surcharge geared to past gas purchases." *Id.* at 12a.[18]

The full court of appeals, with three judges dissenting, denied rehearing *en banc.* Pet. App. 29a-34a. Judge Williams, a member of the panel, in voting to deny rehearing, rejected suggestions that the panel decision "represents a particularly aggressive application of the filed rate doctrine." *Id.* at 32a. To the contrary, he said: "The conclusion seems inescapable that as conceived by the Commission it is a charge for gas service in the 1983-86 period and as such violates the filed rate doctrine." *Id.* Chief Judge Wald, who was not a member of the panel, voted to rehear the case *en banc.* She stated, mistakenly, that FERC's "Order No. 436 . . . allowed [Tennessee's customers] to break [their] contracts prior to purchasing the amount of gas specified in the contracts." *Id.* at 33a. From this, she concluded that "FERC's decision to reallocate some of these current costs did not violate the filed rate doctrine because," as she mistakenly believed, "the deal originally agreed to by [Tennessee's customers] had already been abrogated by the FERC." *Id.*

[18] The court also rejected an attempted distinction between a retroactive charge for gas taken and such a charge for gas not taken: "As a mathematical fact, the charge is as much a result of gas taken during the base period as it is of gas not taken during the deficiency period." Pet. App. 14a.

ARGUMENT

The Natural Gas Act "prevents the Commission itself from imposing a rate increase for gas already sold." *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981) (*Arkla*). FERC's orders in this case were in clear violation of that statutory rule. The D.C. Circuit's decision vacating those orders and remanding to FERC for consideration of lawful recovery mechanisms for Tennessee's buyout and reformation costs was plainly correct and does not warrant this Court's review.

The "restructuring of the natural gas industry" [19] is neither at issue nor at risk in this case: this case involves routine application of longstanding statutory rules for determining how a regulated entity's costs may be recovered through charges to customers. The "equity" and "practicality" arguments marshalled in support of FERC's orders are quite wrong, but even if it had equity on its side, FERC "does not have the power to adopt a policy that directly conflicts with its governing statute." *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, No. 89-624, 110 S. Ct. 2759, 2770 (1990) (*Maislin*).[20]

1. The Act unambiguously bars FERC from ordering a pipeline to collect a surcharge for past gas service, over and above the rates it had on file when the service was provided. Any such order would also conflict with several decisions of this Court.

(a) Section 4(c) of the Act, 15 U.S.C. § 717c(c), requires a pipeline to file "schedules showing all rates and

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[19] *Associated Gas Distribs. v. FERC*, 824 F.2d 981, 993 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988), quoted at Comm. Pet. 7.

[20] *Maislin* arose under a different statute (the Interstate Commerce Act), and it involved agency action purporting to validate lower rates than those on file, rather than higher rates as in the present case. But the holding of that case is squarely on point: here, as there, the rate-regulating agency does not have the "authority to alter the well-established statutory filed rate requirements." 110 S. Ct. at 2770.

charges for any transportation or sale subject to the jurisdiction of the Commission." Tennessee had such rate schedules on file throughout the period 1981-1986 and the rates were approved by FERC.[21] This case concerns 1988 FERC orders that would *change* Tennessee's filed and FERC-approved rates for 1981-1986.

The plain words of the Act require rate changes to be prospective only. Section 4(d), 15 U.S.C. § 717c(d), permits a pipeline to change its filed rates only on thirty days notice, which is effected by filing "new schedules stating plainly the change . . . and the time when the change or changes *will* go into effect." *Id.* (emphasis added). The Commission may waive the thirty days' notice, but only by an order specifying "the time when [the changes] *shall* take effect." *Id.* (emphasis added). The only other way that rates can be changed is by a Commission finding under section 5 of the Act, 15 U.S.C. § 717d, that the filed rates are not just and reasonable, in which case "the Commission shall determine the just and reasonable rate . . . to be *thereafter* observed and in force." *Id.* (emphasis added).

These words of futurity are not an accident. When the Natural Gas Act was adopted, it was already well established that agency ratesetting powers are essentially legislative and that an agency is bound "not to repeal its

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[21] *See, e.g., Tennessee Gas Pipeline Co.*, 19 FERC ¶ 62,600 (1982) (approving uncontested settlement rates, November 1, 1981 through April 1, 1983); *Tennessee Gas Pipeline Co.*, 26 FERC ¶ 61,164 (1984) (approving uncontested settlement rates effective through August 3, 1983, and prospectively from August 4, 1983); *Tennessee Gas Pipeline Co.*, 34 FERC ¶ 61,277, *reh'g granted and order clarified*, 35 FERC ¶ 61,003 (1986) (approving interim settlement rates not subject to later surcharge, for February 1 through April 30, 1986); *Tennessee Gas Pipeline Co.*, 35 FERC ¶ 61,252, *reh'g denied*, 36 FERC ¶ 61,305 (1986) (extending interim rates until approval of pending settlement offer in Docket No. RP85-178); *Tennessee Gas Pipeline Co.*, 40 FERC ¶ 61,145 (1987) (approval of uncontested settlement offer in Docket No. RP85-178 as to rates effective in 1986 and 1987).

own enactment with retroactive effect." *Arizona Grocery Co. v. Atchison, T. & S.F. Ry. Co.*, 284 U.S. 370, 389 (1932) (Interstate Commerce Act).

(b) Consistent with *Arizona Grocery* and the statutory language, this Court has long held that FERC's only power, under section 5 of the Natural Gas Act and the corresponding provision of the Federal Power Act,[22] is to prescribe a new rate to take effect prospectively. FERC has no power "to grant reparations." *Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 254 (1951). The Commission's power "is limited to prescribing the rate 'to be thereafter observed' and thus can effect no change prior to the date of the order." *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956). "[T]he rate found by the Commission to be just and reasonable becomes effective prospectively only." *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378, 389 (1959).

It is equally clear that, except as permitted by its statutory refund authority (15 U.S.C. § 717c(e)), the Commission may not alter a rate retroactively pursuant to a pipeline rate filing under section 4. In *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962), the Court held that even if "a rate for one class or zone of customers [is] . . . found by the Commission to be too low, . . . the company cannot recoup its losses by making retroactive the higher rate subsequently allowed." *Id.* at 152-53. In *Arkla*, the Court gave clear instructions that neither the seller nor the Commission may retroactively increase a seller's filed rates for gas sold in a past period:

> In sum, the [Natural Gas] Act bars a regulated seller of natural gas from collecting a rate other

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[22] Section 206a, 16 U.S.C. § 824e. The Court has an "established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkla*, 453 U.S. at 577 n.7.

> than the one filed with the Commission *and* prevents the Commission itself from imposing a rate increase for gas *already sold* . . . . [T]he ruling of the Louisiana Supreme Court . . . amounts to nothing less than the award of a retroactive rate increase . . . . This, [petitioners] contend, is precisely what the filed rate doctrine forbids. We agree.

453 U.S. at 578-79 (emphasis added).

2. The court of appeals ruled that Tennessee's "deficiency" charge ordered by FERC in 1988 was retroactive and thus barred by the filed rate doctrine. That ruling was clearly correct.

(a) The 1988 FERC-ordered "deficiency" charge is based solely on the extent to which a Tennessee customer's average annual gas purchases in 1983-1986 fell below its average annual purchases in 1981-1982. The customer's compliance with the rates and terms of service that *were* on file (and that had been approved by the Commission) in 1981-86 makes no difference. Even a 1981-86 customer who does not now buy, and is not now entitled to buy, any gas at all from Tennessee is liable for the surcharge if its purchases declined between the past "base period" and the past "deficiency period." [23] The surcharge is, pure and simple, an additional charge for past gas service.

In effect, FERC is now saying to Tennessee's customers: "You did not buy as much gas as Tennessee expected you to during 1983-1986, so we want you now to pay additional charges for the gas you did purchase."

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[23] According to the Commission, if a pipeline customer had terminated its relationship with Tennessee after 1986 but before Tennessee "sought to pass through take-or-pay costs, it is not assessed any liability." Comm. Pet. 26 n.14. But if a pipeline customer terminated its relationship with Tennessee after the Tennessee filing, FERC would require it "to share in the payment of take-or-pay liabilities." *Id.* It is obvious that the charge imposed on the latter customer is for *past* gas service.

But Tennessee's rates on file in 1981-86 were *not* contingent on a customer's maintaining through 1983-86 the same level of purchases it made as in 1981-1982, and neither Tennessee nor the Commission had the right in 1988 to turn the earlier rates into volume-based rates.

(b) Petitioners argue (Comm. Pet. 20; Tenn. Pet. 12) that the only reason why the Act requires rate changes to be filed first and to take effect prospectively is to assure that FERC is "cognizant" of the rates being charged. They suggest that what the Commission labels the " 'predictability' notion" (Comm. Pet. 24) is a mere caprice of the D.C. Circuit, and that Tennessee's "deficiency" charge was not retroactive because, after the Commission's orders in this case, Tennessee of course filed a new tariff containing the surcharge before actually billing its customers. *See* Comm. Pet. 19; Tenn. Pet. 13.

But the purpose of the filed rate doctrine is not merely to prevent utility charges from escaping FERC review. The central purpose is "to render rates definite and certain." *Arizona Grocery Co. v. Atchison, T. & S.F. Ry. Co.*, 284 U.S. at 384, *quoted in Maislin*, No. 89-624, 110 S. Ct. at 2766.[24] Tennessee is one of a chain of entities, each of which needs to know the basis on which it is currently being charged for service in order to make its own contracting and purchase decisions and, if a regulated entity, to make its own prospective rate filings with federal and state agencies. *See Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986); *Mississippi Power &*

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[24] As the D.C. Circuit explained in another recent FERC case:

> The rule against retroactive ratemaking . . . tends to make this highly regulated market approximate ordinary ones, where, for example, General Motors may not, after a sale, demand another $500 to cover its costs, and a buyer may not demand a refund because he just discovered that a competitor had been offering similar cars for less.

Public Utils. Comm'n v. FERC, 894 F.2d 1372, 1383 (D.C. Cir. 1990).

Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988). Since the Commission speaks in such apocalyptic terms about this case, it is not inappropriate to respond that the entire scheme of private, although regulated, gas and electric power transactions would be fundamentally changed if the Commission were free to determine, in hindsight, that filed prospective rates in past periods were not high enough and customers in those periods (including regulated utilities subject to their own filing obligations) should now be surcharged for their purchases during those past periods. The need for certainty in making decisions (and not merely preservation of FERC's jurisdiction) is why section 4(d) requires that notice of changes be given "to the public" (as well as the Commission) and why this Court has said that "the Commission itself has no power to alter a rate retroactively" or to "impos[e] a rate increase for gas already sold" (*Arkla,* 453 U.S. at 578).

The Commission cannot elude these requirements, and impose a retroactive additional charge on gas sold in 1981-86, by the mere formality of ordering a rate filing before the surcharge bills are sent out. As Judge Williams said below, "It is hard . . . to see how [the filed rate doctrine] would retain any force if the proposed purchase deficiency charge were allowed. It is virtually indistinguishable from the Commission's substituting in 1988 a new rate schedule for gas purchased in 1983-86." Pet. App. 32.

(c) The Commission acknowledges (Comm. Pet. 24) this Court's statement that a utility, having filed its rates, "must, under the theory of the Act, shoulder the hazards . . . including . . . its losses where the filed rate is found to be inadequate." *FPC v. Tennessee Gas Transmission Co.,* 371 U.S. at 153. But here, FERC says, "Tennessee sought to collect an entirely new charge to recover *current* costs, based on circumstances that were dramatically different from those in existence when its earlier rates were on file." Comm. Pet. 24.

That argument is sheer sleight of hand. First, if FERC means to suggest that the costs came as a surprise, there is ample evidence that Tennessee knew by late 1982 that it had a significant problem.[25] More important, what makes the charges unlawfully retroactive is adding them, on top of the filed rates paid at the time, to the charge for gas service in a past period; FERC's insistence that the costs are "current" only reinforces the objection to assessing the charges solely on the basis of respondents' purchase decisions in 1981-86, which were based on Tennessee's filed tariffs during that past period.[26] And the fact that two thirds of the costs are being incurred today to reduce Tennessee's gas cost tomorrow makes it even more objectionable to impose the charges based on purchase decisions made yesterday.

(d) Petitioners,[27] and to some extent Chief Judge Wald in her dissent from the denial of rehearing *en banc*,[28] defend the "deficiency" charge on the ground that costs should be borne by the customers that "caused" them. But this argument misstates both the facts and the relevant principles of ratemaking.

Tennessee's claim to a surcharge is not based on any finding that the surcharged customers either (i) induced Tennessee to enter into "long-term contracts to purchase

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[25] *See* Pet. App. 62a-63a; 67a-69a; *see also* Appendix, *infra*.

[26] As Judge Williams said, "If current gas costs surged, for example, and the Commission responded by authorizing a surcharge on individual customers' 1984 takes, the violation of the filed rate doctrine would be plain." Pet. App. 31a. The ratemaking question whether it is proper to include particular costs in the rates for a particular period, *see, e.g., Public Serv. Co. of New Hampshire v. FERC*, 600 F.2d 944, 958 (D.C. Cir.), *cert. denied*, 444 U.S. 990 (1979), is entirely different from the present question, which is whether it is permissible to reset charges for gas sold in a prior period.

[27] Comm. Pet. 23-24; Tenn. Pet. 8; Nat. Fuel Pet. 16.

[28] Pet. App. 33a-34a.

additional gas supplies at high prices and subject to high take-or-pay requirements," Order No. 500-H, FERC Stats. & Regs. at 31,509, or (ii) failed to meet any of their own contractual obligations. Tennessee acted on the basis of its own projections of customer needs and market trends, *see* Pet. App. 58a-59a, primarily in order "to assure a source of supply for gas" for customers it had agreed to serve—many of which were at the time without alternative sources of gas. Comm. Pet. 22.

By Tennessee's own estimate, only one-third of its costs are for buying out accumulated exposure for unpaid take-or-pay claims, *see* p. 3, *supra*, and, even as to this one-third, the surcharged customers cannot be said to have "caused" the costs except in the sense that anyone's failure to purchase anything "causes" the vendor thereof to have a larger inventory than he otherwise would.[29] To the extent that Tennessee's take-or-pay liability accumulated in the period 1983-86, it would obviously have been lower if no 1981-82 customer had reduced its purchases in 1983-86.[30] But a customer whose own needs declined, because of conservation by residential customers or for other reasons, or which, with FERC's encouragement, sought lower priced supplies elsewhere, did not "cause" Tennessee's oversupply any more than a customer who delays replacing his aging Chevrolet "causes" General Motors' "resulting" inventory surplus.

In any event, Tennessee alleged and, in 1988, FERC agreed that two-thirds of Tennessee's estimated costs were for prospectively reforming its gas supply contracts

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[29] As a factual matter, it is equally true that customers who failed to *increase* their purchases in 1983-86 likewise "caused" Tennessee's oversupply.

[30] It would also have been lower if Tennessee had *made* the take-or-pay prepayments, in which event, under standard FERC practice, the costs would (if prudently incurred) have been added to Tennessee's rate base and recovered through future rates rather than a retroactive surcharge. *See* Pet. App. 71a, 108a-109a.

to reduce or eliminate the continuing gap between the prices Tennessee had contracted to pay and the projected market price of gas. As to that two-thirds, the statement that customers whose purchases declined in 1983-86 were the "cause" makes no sense whatever: customer purchase decisions in 1983-86 did not cause the gap between Tennessee's purchase contract prices and market prices; the reformation costs were incurred to make Tennessee's gas marketable, and they serve to reduce the prices at which Tennessee can sell gas in the future—benefiting current and future customers, not past ones.

Even if the "cost causation" theory had a sound factual basis, there simply is no rule that permits the Commission to adjust filed rates retrospectively so that costs will be borne by customers the Commission judges, in hindsight, to have had some role in "causing" them.[31] To the contrary, pipelines and their customers are private entities that enter into contracts based on perceptions of their current and future needs. The Commission's role, as this Court has said many times, is to ensure that the terms of those contracts are just and reasonable, not to "award reparations on the ground that a properly filed rate or charge has in fact been unreasonably high or low." *Montana-Dakota Utils. Co. v. North-*

[31] Petitioners' citations in support of their cost-causation theory are misplaced: the cases concern only the design of prospective rates, in which costs of service are one of several factors considered in setting just and reasonable rates. For example, in *Public Sys. v. FERC*, 709 F.2d 73 (D.C. Cir. 1983), cited in Comm. Pet. 23, the court of appeals held that in setting rates costs should be allocated in such a manner that "the customers who pay the expense receive the tax benefit associated with that expense." *Alabama Elec. Coop., Inc. v. FERC*, 684 F.2d 20 (D.C. Cir. 1982), and *Cities of Riverside & Colton v. FERC*, 765 F.2d 1434 (9th Cir. 1985), involved the principle that, to avoid discrimination, rates should be set so that revenues from each class of customer match as closely as possible the costs of "providing service" to that class. *Alabama Elec.*, 684 F.2d at 27. None of these cases suggests that reparations or surcharges for past periods are permissible.

western Pub. Serv. Co., 341 U.S. at 258 (Frankfurter, J., dissenting).

(e) Petitioners' argument is not helped by their invocation of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). *Chevron* requires no deference to agency assertions of authority that are contrary to the authoritative construction of a statute by this Court. *Id.* at 843 n.9; *accord, Board of Governors of Federal Reserve Sys. v. Dimension Fin. Corp.*, 474 U.S. 361, 368 (1986); *INS v. Cardoza-Fonseca*, 480 U.S. 421, 466-68 (1987).[32] In *Maislin*, this Court's most recent examination of the filed rate doctrine, the Court used words strikingly applicable here: "Once we have determined a statute's clear meaning, we adhere to that determination under the doctrine of *stare decisis*, and we judge an agency's later interpretation of the statute against our prior determination of the statute's meaning." 110 S. Ct. at 2768.

(f) Equally misplaced is petitioners' reliance on the "end result" test of *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). *Hope Natural Gas* was concerned with judicial review of rates set by an agency that has properly exercised its statutory authority; nothing in that case suggests that "reasonableness" displaces all statutory requirements. To the contrary, numerous decisions make clear that the first duty of a reviewing court is to ensure that the agency has not "abused or exceeded its authority." *E.g., In re Permian Basin Area Rate Cases*, 390 U.S. 747, 791-92 (1968). If the agency has exceeded its authority, its actions cannot be saved by the alleged reasonableness of the end result. *See, e.g., United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332

[32] The Court has recently reaffirmed the respect "this Court must accord to long-standing and well-entrenched decisions, especially those interpreting statutes that underlie complex regulatory regimes." *California v. FERC*, No. 89-333, 110 S. Ct. 2024, 2029 (1990).

(1956); *Public Serv. Comm'n v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983).

(g) This case is not at all like *Mobil Oil Exploration & Producing Southeast, Inc. v. FERC*, 885 F.2d 209 (5th Cir. 1989), *cert. granted, Mobil Oil Exploration & Producing Southeast, Inc. v. United Distrib. Cos.*, No. 89-1452, 110 S. Ct. 2585 (1990), cited "passim" by Tennessee. In that case, the Solicitor General represented to this Court that the Fifth Circuit's decision would call into question some 1600 producer-pipeline contracts, possibly unravel settlements of numerous take-or-pay disputes, lead to widespread state-court litigation, and recreate serious distortions in the natural gas market, increasing dependence on foreign oil and gas.[33] Nothing of the sort is shown here: the decision below will result at most in the administrative cost and inconvenience of revising an unlawful scheme of charges to pipeline customers.[34]

3. Petitioners also attempt to suggest that a retroactive "deficiency" charge is the only equitable solution to Tennessee's problem. Although the dispositive answer to this argument is that the charge is not a *lawful* solution, we note briefly that it is not equitable either, and that it is by no means the only solution.

The "deficiency" charge severely punishes those Tennessee customers that, in the particular period 1983-86, reduced purchases because *their* customers were conserving energy, or because they or their customers responded to the encouragement of the Commission or state regulators to "pursue least-cost [gas purchase] strategies." Order No. 380, FERC Stats. & Regs. at 30,964. First,

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[33] Response for the Federal Energy Regulatory Commission Supporting Application for Stay, No. A-503, at 19.

[34] The Commission has recently recognized that revising the method of spreading take-or-pay and contract reformation costs among pipeline customers does not affect the Commission's basic "equitable sharing" policy. *Northern Natural Gas Co.*, 52 FERC ¶ 61,044 at 61,203 (1990).

the deficiency charge resulting from each Mcf of gas not purchased will almost surely far exceed the cost savings from buying an Mcf from another supplier.[35] Second, as previously noted, two-thirds of the costs that would be borne by customers whose purchases declined in 1983-86 are estimated by Tennessee and FERC to be for prospective contract reformation and have nothing to do with the amount of gas Tennessee sold in 1983-86. Third, these customers, including pipelines, other utilities, and end users, obviously could not timely reflect the retroactive surcharge in their own purchase decisions and rate filings for the 1981-86 period.[36]

Nor is a retroactive purchase deficiency charge the only way to solve the take-or-pay problem. The traditional way of recovering the cost of gas supplies (if prudently incurred) is to include them in current commodity

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[35] Tennessee has computed customers' deficiency allocation factors based on approximately 383 million Mcf in total average annual deficiencies during the 1983-86 period. *See* Tennessee tariff filing March 31, 1989, and Schedule 5a of supporting workpapers, approved in part by the Commission, *Tennessee Gas Pipeline Co.*, 47 FERC ¶ 61,137 (1989). If Tennessee were ultimately to bill up to its cap of $650 million under this method, customers would be now charged approximately 42 cents for each Mcf of gas not taken from Tennessee during the four-year deficiency period. This is substantially larger than the price differential normally sufficient to induce a customer to pursue lower cost alternatives.

[36] The court of appeals properly rejected the contention that language in Order No. 380 addressing possible future changes concerning recovery of carrying charges on take-or-pay prepayments somehow notified a pipeline's customers to expect a surcharge:

> Order No. 380 post-dated the entire base period and half of the deficiency period. The Commission can perhaps assume that petitioners have some acquaintance with regulatory changes in the natural gas industry, but it cannot require them to be clairvoyant. Upon consideration of the text of Order No. 380, we conclude that FERC's indication that carrying charges on prepayments 'may require special consideration' is delphic at best . . . .

Pet. App. 14a.

rates. The Commission endorsed that approach to take-or-pay contract buyout and reformation costs in its 1985 Policy Statement, *see* p. 8, *supra*, and the Commission's current regulation, 18 C.F.R. § 2.104(a), provides that "pursuant to existing Commission policy and practice . . . pipelines may pass through prudently incurred take-or-pay buyout and buydown costs in their sales commodity rates."

Another alternative would be a direct charge allocated in accordance with current contract entitlements. As described above, *see* p. 10, *supra*, Tennessee proposed and the Commission initially approved that method for recovering some of the take-or-pay buyout costs and all of the contract reformation costs (estimated to be two-thirds or more of the total) and the Commission's later change of mind on that proposal was virtually unexplained.[37] Still another method conceded by the Commission to be "potentially available," Comm. Pet. 28, is a "volumetric" surcharge on future rates for both sales and transportation of gas; "open access" pipelines are already allowed by Order No. 500 to use this method to recover up to 50 percent of their buyout and reformation costs, and FERC itself has endorsed and defended the method in a number of recent decisions.[38]

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[37] The D.C. Circuit has found that this method of recovering deferred gas costs would not violate the filed rate doctrine or be otherwise unlawful as to amounts accruing prospectively from the issuance of the Commission's order approving such method. *Transwestern Pipeline Co. v. FERC*, 897 F.2d 570, 579 (D.C. Cir. 1990).

[38] *E.g., Transcontinental Gas Pipe Line Corp.*, 51 FERC ¶ 61,297 at 61,955 (1990); *CNG Transmission Corp.*, 51 FERC ¶ 61,158 at 61,433 (1990); *Northern Natural Gas Co.*, 51 FERC ¶ 61,157 at 61,431-32 (1990) (approving settlement using only volumetric surcharge and no direct billing). In these cases, the Commission justifies the prospective allocation of a portion of the take-or-pay costs to transportation customers not because these customers "caused" the pipeline's take-or-pay problem, but because they are benefiting from the transition of the pipeline to open-access status.

The choice among the lawful approaches to the recovery of these costs should be made in the first instance by the Commission, and the court of appeals properly returned the case to the Commission to choose among the alternatives that are permitted by the statute. As this Court said of the Interstate Commerce Commission in *Maislin*: "Although the Commission has both the authority and expertise generally to adopt new policies when faced with new developments in the industry, . . . it does not have the power to adopt a policy that directly conflicts with its governing statute." 110 S. Ct. at 2770.

CONCLUSION

For the reasons stated above, the petitions for writ of certiorari should be denied.

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